United States Senate

Republican Policy Committee

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Originally Issued: March 4, 2005
Updated: June 21, 2006

Updated Data Confirm Potential Harm

Can We Raise the Minimum Wage Without Hurting the Working Poor?

Executive Summary

- In March 2005, the Senate Republican Policy Committee released an analysis of the impact that increasing the minimum wage has on the working poor. This paper incorporates new data to confirm the harmful effect a raise in the minimum wage will bring.

- On June 19, 2006, Senator Edward Kennedy proposed a three-step, 41-percent increase in the federal minimum wage that would raise the hourly rate by $2.10 – to $7.25 – over 26 months.

- The minimum wage is an outdated and ineffective government-imposed mechanism for raising the standard of living.

- Only 2.5 percent of today's hourly workers earn the minimum wage – a percentage that has been dropping since the last hike in 1996.

- About one-half of minimum-wage earners are under age 25; nearly 60 percent are part-time workers; and nearly 70 percent live in households with family incomes above the poverty level for a family of four.

- Even without a mandate from the federal government, employers are giving raises to their minimum-wage workers: two-thirds of workers who start at the minimum wage will see an increase in their salary within a year. That increase averages 10 percent.

- Minimum-wage hikes create winners and losers: winners earn a higher hourly wage (one they likely would have earned absent a government mandate); losers face a reduction in hours or benefits, job termination, or – in the case of new job seekers – fewer choices as fewer minimum-wage jobs are created.

Introduction

On June 19, 2006, Senator Edward Kennedy offered an amendment to S. 2766, the National Defense Authorization Act for Fiscal Year 2007, that would increase the minimum wage by $2.10. If enacted, this 41-percent increase would be the largest ever in the history of the federal minimum wage.[1]

Increasing the minimum wage is not an effective way to improve living standards for the nation's working poor and, for some, will actually cause more harm than good. Most of America's lowest-wage workers already have been able to raise their incomes above the minimum wage without government interference. Meanwhile, federally imposed increases in the wage rate prevent many employers from hiring new employees. It may well also result in employees losing benefits, hours – or even their jobs.

Moreover, if Congress does decide to pass an increase in the wage rate, it should work to minimize the negative impacts on the economy by mitigating injury to employees and small businesses.

Democrats Propose Largest Increase Ever

If enacted, the Kennedy proposal to increase the minimum wage would be the largest increase in history. The minimum wage is currently set at $5.15 an hour, and was last increased in 1996 – via a two-step, 90-cent increase over 13 months. The amendment offered this week by Senator Kennedy mandates that the minimum wage be increased by $2.10 over 26 months. An increase of $2.10 is significantly higher than all of the nine past increases in the law's history; since the minimum wage was created in 1938, legislation to increase it by more than $1 has only been enacted on one occasion, when it was increased by $1.15 in four increments from 1978 to 1981.

Raising the minimum wage is often on Democrats' "to do" list – and in fact, they offered a bill to increase the minimum wage further in 1996 *even before* the last increase was fully in place.[2] Interestingly, when Democrats controlled the Senate chamber for half of 2001 and 2002, they did not bring a bill to raise the minimum wage to the floor (although several were introduced and two were on the Senate Calendar). Yet now that Republicans are in the majority, Senate Democrats have offered amendments to increase the minimum wage three times in the last 15 months.[3]

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[1] The federal minimum wage was created as part of the Fair Labor Standards Act of 1938 (29 U.S.C. 201), enacted August 9, 1939. For a comprehensive list of past increases see CRS, "The Fair Labor Standards Act: Minimum Wage in the 108th Congress," RL30993, December 16, 2003.

[2] Two months before the second step of the 1996 increase even went into effect, Senator Kennedy filed S. 1009 (106th Congress), which would have raised the minimum wage from its soon-to-be level of $5.15 to $7.25, an increase of $2.10 (or 40 percent).

[3] In addition to the amendment offered June 19, 2006, an amendment was offered to H.R. 3058, the Transportation Appropriations bill for FY 2006, October 19, 2005, vote number 257. Prior to that, a minimum wage increase amendment was offered to S. 256, the Bankruptcy Abuse Prevention and Consumer Protection Act, March 7, 2005, vote number 26. Both amendments failed.

A Look at Minimum-Wage Earners

Only 1.9 Million Workers Earn It – Two-Thirds Receive Pay Increase Within a Year

Each year since the last federally mandated increase in 1996, a smaller percentage of the workforce has earned the minimum wage. In 1980, more than 15 percent of hourly paid workers, or nearly 8 million people, earned the minimum wage. In comparison, in 2005, only 2.5 percent of hourly paid workers, or 1.9 million people, earned the minimum wage. In response to market forces – instead of government mandates – salaries have increased since the last mandated wage hike in 1996; in fact, hourly wages have outpaced inflation in most categories measured by the Bureau of Labor Statistics (BLS).[4]

According to a study that looked at workers over a 20-year period, two-thirds of those who started at the minimum wage earned a raise within the first year – without a government mandate.[5] The same data reveal that the average first salary increase for workers who started at the minimum wage was 10 percent.[6]

Most Minimum-Wage Earners Are Not the Family Breadwinner and Are Above the Poverty Level

The largest proportion of minimum-wage earners is made up of teenagers or young adults who have just entered the workforce. In 2005, about one-fourth of minimum-wage earners were teenagers between ages 16 and 19, and about one-half were between the ages of 16 and 24.[7] In a 2001 analysis of minimum-wage workers under the age of 24, some two-thirds were found to be in school and working less than full time.[8] In all, more than 59 percent of minimum-wage earners only work part-time.[9] Thus, it should come as no surprise that few minimum-wage earners are the sole income earners in their households.

Using 2005 government data, the Employment Policies Institute determined that only 15 percent of minimum wage earners are raising a family on the minimum wage. In contrast, the remaining 85 percent are teenagers living with their working parents, adults living alone, or dual-earner married couples.[10] It is also determined that the average *family* income of a minimum wage worker is over $43,000 a year.[11] This income was – and still is – more than more than 200 percent above the poverty rate for a family of four. (In 2005, the poverty rate was $19,350, and in 2006 it

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[4] BLS earnings data available at http://www.bls.gov.
[5] William Even and David Macpherson, "Rising Above the Minimum Wage," Employment Policies Institute, January 2000. See also: William Carrington and Bruce C. Fallick, "Do Some Workers Have Minimum Wage Careers?" *Monthly Labor Review,* May 2001.
[6] Even and Macpherson.
[7] Bureau of Labor Statistics, "Characteristics of Minimum Wage Workers: 2005," May 2006.
[8] D. Mark Wilson, "Who is Paid the Minimum Wage and Who Would be Affected by a $1.60 per Hour Increase," Heritage Foundation, June 28, 2001.
[9] Bureau of Labor Statistics, "Characteristics of Minimum Wage Workers: 2005," May 2006.
[10] Employment Policies Institute, "Helping Low-wage Americans. The Earned Income Tax Credit: An Effective Solution to an Age-old Problem," January 2006.
[11] Employment Policies Institute, "Helping Low-wage Americans. The Earned Income Tax Credit: An Effective Solution to an Age-old Problem," January 2006.

is $20,000.) Granted, this still means some minimum-wage workers are in low-income households, but it is an exaggeration to suggest that all live in poverty.

For those minimum-wage workers who *do* live in poor households, the government, at both federal and local levels, already provides more effective ways to improve their standard of living than an increase in the minimum wage. For example, all families with minimum-wage-level incomes are eligible for the Earned Income Tax Credit, which supplements incomes by as much as $4,400 (for a single adult with two dependents), amounting to a cash credit equal to more than $2 an hour.[12] Additionally, such workers may be eligible for housing assistance, food stamps, health insurance subsidization, child care subsidization, and energy aid – all programs which provide substantial income assistance.

Helping Some Workers, at the Expense of the Most Vulnerable Workers

Minimum Wage Ineffective in Helping the Working Poor

Although the stated rationale for increasing the minimum wage is to increase the standard of living for working poor Americans, the effect is the opposite for some workers. There is no question that the minimum-wage workers who keep their jobs would see an increase in hourly pay on their pay stub. Yet, that does not mean those workers all would benefit. Some would see lower earnings from reduced shifts; others would see reduced benefits. Some would lose their jobs, and others would not be able to find a job. As expressed by then U.S. Senator Phil Gramm, "The cruel hoax of minimum wage laws is, by setting artificially high wages, it prevents people from getting their foot on the first rung of the economic ladder. It prevents them from getting into the most effective job training program in history: on-the-job training."[13]

Because the number of people earning the minimum wage is so small relative to the entire workforce, the negative employment impact for some low-income individuals may go unnoticed on national economic measures. However, National Bureau of Economic Research economists determined that increases in the minimum wage do lead to reduced hours and lower earnings for minimum-wage earners. After comparing data from states that did and did not raise their minimum wage, the economists estimated the income effect for minimum-wage workers "is on the order of a 6-percent decline."[14] This clearly demonstrates that, overall, the lowest-income workers are hurt more than they are helped by a mandatory wage hike.

The negative effects of government wage intervention fall most heavily on the shoulders of the most vulnerable workers. When employers are forced to cut employees or reduce their hours, they naturally will retain the most skilled and productive employees and not the less-skilled, lower-wage earners, therefore harming most those who have the least ability to get another job. Those who are the slowest to move up from the minimum wage are older, less educated, less trained, more likely to work part time, and are more often minorities and women.[15] It is logical to

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[12] Internal Revenue Service, Form 1040 Instructions 2005, p. 45-58.
[13] Senator Phil Gramm (R-TX), *Congressional Record*, May 22, 2002.
[14] David Neumark, Mark Schweitzer, and William Wascher, "The Effects of Minimum Wages Throughout the Wage Distribution," National Bureau of Economic Research, NBER Working Paper 7519. 2000.
[15] Even and Macpherson.

assume that these same employees are the ones most likely to have their hours reduced or to be terminated if an employer is forced to scale back on his costs.

Another often-ignored consequence of increasing the federal minimum wage is its impact in areas with little economic development where employment is scarce. The Employment Policies Institute has identified 397 local communities – home to 24 million Americans – where unemployment averaged above 9 percent in 2002, compared to the national average of just under 5.8 percent that year.[16] The national rate stood at 4.6 percent in May 2006. The negative effects of a minimum-wage increase on low-income workers would sink these communities even further into economic distress. Would Congress even consider raising the minimum wage if national unemployment were 9 percent or, – as it is in Yuma, Arizona – 13 percent?[17] Yet the Kennedy proposal would impose the 41-percent minimum-wage increase in every county in America, regardless of economic conditions there.

Minimum Wage Increase Harmful to Teen Employment

Minimum wage jobs are often the first job to many new entrants to the labor force. These starter jobs are valuable in that they teach people work skills, such as the value of showing up on time and being courteous to customers. However, even a 10-percent increase in the minimum wage – let alone the 41-percent increase proposed by Senator Kennedy – takes away these first jobs critical to later success.

Specifically, University of Georgia Professor Joseph Sabia found that a "10 percent increase in the minimum wage is associated with a 2.7 to 4.3 percent decline in teen employment in the retail sector, a 5 percent decline in average retail hours worked by all teenagers, and a 2.8 percent decline in retail hours worked by teenagers who remain employed in retail jobs."[18] The effect is even greater on small businesses. Sabia found that a 10-percent increase in the minimum wage is associated with a 4.6 to 9.0 percent decline in teenage employment in small businesses and a 4.8 to 8.8 percent reduction in hours worked by teens in the retail sector.[19]

Additionally, another study by Professor Sabia and Cornell economic professor Richard V. Burkhauser estimated that a minimum wage hike to $7.25 an hour would add $18.3 billion in costs on mostly small and local businesses with typically thin profit margins.[20] Furthermore, only 13 percent of this money would go to families that can actually be described as poor.[21]

From its creation in 1938, the minimum wage has proven to be a crude tool for improving the standard of living. The ineffectiveness of this mandate is only more apparent today. As discussed above, most minimum-wage earners live above the poverty level and a substantial percentage are teenage students living at home who may work only part time. These workers will not earn the minimum wage for long anyway; however, they will be the ones most likely to benefit

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[16] Craig Garthwaite, "Where the Jobs Aren't," Employment Policies Institute, July 2003.
[17] Bureau of Labor Statistics, "Metropolitan Area Employment and Unemployment: April 2006," May 31, 2006.
[18] Joseph J. Sabia, Professor of Consumer Economics at the University of Georgia, "The Effects of Minimum Wage Increases on Retail and Small Business Employment," May 2006. (available at www.epionline.org/studies/sabia_05-2006.pdf)
[19] Sabia.
[20] Richard V. Burkhauser and Joseph J. Sabia, "Raising the Minimum Wage: Another Empty Promise to the Working Poor," written for the Employment Policies Institute, August 2005. (available at www.epionline.org)
[21] Burkhauser and Sabia.

from the increase, while those who do not have the skills to move above a minimum-wage job will face hourly reductions, benefit cuts, or job loss.

A Less Harmful Way to Increase the Minimum Wage

The facts are these: the minimum wage affects a very small group of workers. A government-mandated increase is unnecessary for the majority of minimum-wage workers who, simply by becoming more valuable in the workplace, will merit pay raises. Furthermore, mandating an increase will have negative consequences for the least-valued workers. Yet, the political pressure to increase the minimum wage is sometimes impervious to these truths. If that proves to be the case, Congress must act to mitigate the negative consequences of the mandate for both employees and employers.

A plan to raise the minimum wage in a less harmful way has been set forth by Senator Mike Enzi. This plan would implement a more moderate increase and provide tax and regulatory relief for employers. Specifically, his plan would increase the minimum wage by $1.10 via two steps, setting the first increase of 55 cents beginning 6 months after enactment and the second increase of 55 cents after 18 months. This more tempered approach is consistent with past increases. Most importantly, Sen. Enzi's plan contains multiple measures to mitigate the injury to workers and employers.

Small Business Protection

For a small business, a sudden, 41-percent increase in the pay of minimum-wage workers may be difficult to absorb. Such a negative jolt for small businesses can have a significant effect on national employment: small businesses employ more than half of all private-sector employees and generate 60 percent to 80 percent of net new jobs annually.[22] Current law provides a small-business exemption to protect small businesses from the harmful effects of the minimum wage. That exemption now covers businesses with a gross annual sales volume of less than $500,000, but it has not been updated since 1989. Raising the limit would allow additional small businesses to qualify for the exemption. For this reason, Senator Enzi has proposed expanding the small-business exemption to $1 million in gross sales volume.

Additionally, the Enzi amendment would restore the original intent of the small-business exemption – that it apply broadly. Currently, as implemented by the Department of Labor, the small-business exemption does not cover workers engaged in interstate commerce – even if they work for an employer who is exempt based on sales volume. That is, those employees whom the Department of Labor determines to be engaged in interstate commerce may not be subject to the exemption. This implementation of the law evades the intent of the small-business exemption and eliminates it for many employers. The Enzi amendment corrects this.

[22] Small Business Administration, "Frequently Asked Questions," June 2006.

Simplified Compliance with Federal Labor Laws

To address the negative employment consequences of a minimum-wage increase, such as reduced hours or unemployment, Senator Enzi has proposed including four specific labor- law reforms that will benefit employees and encourage employers not to downsize. They are summarized below:

Tip Credit – First the amendment would require tips to be credited for purposes of complying with any future minimum-wage increases in those states where state law currently prohibits them from being credited.

Flex-Time – Second, the proposal would add a measure of flexibility to the rigid labor law that prohibits compensatory time off in lieu of overtime pay. The flex-time proposal would allow employees *to choose* to work extra hours in one week to allow for paid time off in the next week. Current law prohibits making this choice available to most private-sector employees. However, federal and state employees have long enjoyed this flex-time privilege.

- Gives employers and employees the option of a two-week, 80-hour work period during which, without incurring an overtime penalty, up to 10 hours could be "flexed" between the two weeks. For example, employees could, if agreed upon by their employers, choose to work 48 hours one week to offset a paid day off during the following week. Employers would not be required to pay overtime rates (time-and-a-half) until after the employee worked more than 50 hours in one week or more than 80 hours in two calendar weeks. For hours worked in excess of 80 in a two-week period, a worker would have to be compensated at a rate of not less than time-and-a-half.

- An employee may withdraw an agreement at any time by submitting a written notice of withdrawal to the employer. An employer may discontinue offering flex-time after providing 30 days' notice.

Fair Labor Standards Act (FLSA) Paperwork Errors – Third, the measure would reduce the burden of unfair penalties imposed on employers for first-time paperwork errors committed while intending to comply with the Fair Labor Standards Act. Current law gives the Secretary of Labor discretion to waive the penalty for an employer who commits a one-time FLSA paperwork error. With this proposal, the waiver of penalties for first-time paperwork errors would be mandatory.

Improving Regulatory Flexibility – Lastly, this measure would amend the Regulatory Flexibility Act to set a clearer standard for when agencies must produce Compliance Assistance Guides to assist small businesses in complying with the regulation, and to set standards for what information must be included in the guides.

Tax Incentives

Senator Enzi also proposes coupling the $1.10 increase with the following tax incentives targeted to small businesses; they are expected to be fully offset. The incentives would do the following:

- Extend through 2011 current law regarding small business expensing of new equipment. Specifically, it would extend the $100,000 limit allowing small businesses to purchase new equipment and still qualify for immediate expensing.
- Allow the cash-basis accounting method to be an option for small businesses with gross revenues up to $10 million, regardless of inventories.
- Provide a 15-year recovery period for certain restaurant building and related improvements. This provision enhances the provision passed in the American Jobs Creation Act of 2004 by including new restaurant construction in the “restaurant” classification.

Conclusion

Advocates of a higher minimum wage must acknowledge that many of the working poor would be hurt if their 41-percent increase were enacted. This proposal begs the question: which is better – to be employed at a lower wage rate, or not to be employed at all? If Congress does move to increase the minimum wage, it should adopt a smaller, more gradual increase, and offset the negative consequences of a wage hike with measures to protect the small businesses that generate a majority of all new jobs and employ most Americans. Additionally, Congress should simultaneously ease the burden of higher labor costs by adopting tax and regulatory relief for employers.